

Internal Revenue Service

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Department of the Treasury

P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4 - PLR-139685-01
Date: JULY 19, 2002

In re:

Legend:

Settlor =
Trust =
Beneficiary =
A =
Court =

State =

Dear :

This responds to your letter dated July 10, 2001, and subsequent correspondence, requesting rulings regarding the generation-skipping transfer (GST) tax consequences of the proposed modification of certain trusts.

FACTS

The facts submitted and representations made are as follows. Over many years, Settlor has created separate irrevocable trusts for the benefit of each of his grandchildren and great-grandchildren. The terms of all the trusts are substantially identical. The trust at issue in this ruling request, Trust, was created after September 25, 1985, for the benefit of Beneficiary. A is currently serving as trustee. You represent that Trust has an inclusion ratio of greater than 0 for purposes of the GST tax.

Article Five, Paragraph B. of the trust instrument provides as follows:

The Trustee shall accumulate the income of the trust estate and may pay to the beneficiary as much of the accumulated income and principal thereof as the Trustee shall determine in the Trustee's discretion to be necessary and

appropriate for the beneficiary's support, education, care and maintenance, in accordance with the beneficiary's accustomed standard of living.

Article Five, Paragraph B.1. provides:

Upon the last to occur of (i) the attainment of age 35 by the beneficiary or (ii) the death of all Trustees identified in Exhibit "A" hereto as the "Measuring Lives," this Trust shall terminate and the trust estate shall be distributed, free of trust, to the beneficiary. If the beneficiary dies before becoming entitled to distribution of the trust estate the trust estate shall be distributed, free of trust, to the beneficiary's then living issue, by right of representation, or if there are no such then living issue, to such of the issue of the Trustees identified in Exhibit "A" hereto as the Measuring Lives as are then living, by right of representation. However, if any part of the trust would be distributed to a person for whose benefit a trust is then being administered which is substantially identical to the trust created by this instrument, that part shall instead be added to that trust and shall thereafter be administered according to its terms.

Article Six, Paragraph I of Trust provides that, any other provision of Trust notwithstanding, income and principal of the trust estate shall not be utilized to discharge the legal obligation of any person to support a trust beneficiary.

The parties desire to facilitate Trust's qualification as a qualified subchapter S trust for purposes of § 1361 of the Internal Revenue Code. Therefore, as permitted under the laws of State, the parties propose to petition the Court with jurisdiction over Trust to obtain an order from the Court approving the following proposed modification of Article Five, Paragraph B. of the trust instrument to read as follows:

The Trustee shall distribute all of the income (within the meaning of Section 643(b) of the Internal Revenue Code) of the trust estate currently and may pay to the beneficiary as much of the principal thereof as the Trustee shall determine in the Trustee's discretion to be necessary and appropriate for the beneficiary's support, education, care and maintenance, in accordance with the beneficiary's accustomed standard of living.

We have been asked to rule that the proposed modification will not constitute an addition to corpus and will not alter the inclusion ratio of Trust for generation-skipping transfer tax purposes.

LAW AND ANALYSIS

Section 2601 imposes a tax on every generation-skipping transfer. Under § 1433(a) of the Tax Reform Act of 1986, GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Tax Reform Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax

Regulations, the tax does not apply to a transfer from a trust, if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date.

Section 2602 provides that the amount of the tax imposed by § 2601 is the taxable amount multiplied by the applicable rate. Section 2641 provides that the term “applicable rate” means, with respect to any generation-skipping transfer, the product of (1) the maximum Federal estate tax rate, and (2) the inclusion ratio with respect to the transfer. Section 2642(a) provides that the inclusion ratio is the excess, if any, of 1 over the applicable fraction determined for the trust from which the transfer is made or, in the case of a direct skip, the applicable fraction determined for the skip. The applicable fraction is a fraction in which the numerator is the generation-skipping transfer tax exemption allocated to the trust or, in the case of a direct skip, allocated to the property transferred, and the denominator is the value of the property transferred to the trust or transferred in the direct skip, reduced by any Federal estate tax or state death tax actually recovered from the trust attributable to the property and any charitable deduction allowed under §§ 2055 and 2522 with respect to the property.

Section 2631 (a) provides that for purposes of determining the inclusion ratio in the case of generation-skipping transfers on or before December 31, 2003, every individual is allowed a GST exemption of \$1,000,000 (adjusted for inflation under § 2631(c)) that may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax will not cause the trust to lose its exempt status.

Section 26.2601-1(b)(4)(i)(D) provides that a modification will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. A modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST transfer or the creation of a new GST transfer.

No guidance has been issued regarding the GST tax consequences of a modification of a trust that was created after September 25, 1985, or to which contributions have been made after that date. However, a modification that would not affect the GST tax status of a trust that is exempt from tax under § 26.2601-1(b)(1), (2), or (3) should similarly not affect the GST tax status of a trust to which contributions have been made after September 25, 1985. In this case, the proposed modification will not result in a shift of any beneficial interest in Trust to a lower generation beneficiary,

nor will the modification extend the time for vesting of any beneficial interest in Trust. Accordingly, we conclude that the proposed modification of Trust will not effect the inclusion ratio with respect to Trust.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

By _____
George L. Masnik
Chief, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for section 6110 purposes

cc: